

A revised moratorium to help business rescue: A review of the latest reform proposals

On Sunday 26th August 2018, the Government unexpectedly published proposals for the most significant changes to the corporate insolvency framework since the enactment of the Enterprise Act 2002. The Government's response *Insolvency and Corporate Governance* ("the Response")¹ brings together the Consultations *Insolvency and Corporate Governance* from March 2018 and *A Review of the Corporate Insolvency Framework: A consultation on options for reform* from May 2016 ("the 2016 Consultation").² Both of these Consultations identified the UK's status as an attractive place to do business, and sought to sustain and improve this. The Response sets out a raft of reforms to *inter alia* enable more companies to be rescued or restructured and to increase returns to creditors in insolvency situations. This article will consider the proposals developed in the Response from the central tenet of the 2016 Consultation, the introduction of a new restructuring moratorium.

The rationale for a moratorium

The moratorium has been part of the UK insolvency framework as a device to support rescue since the introduction of administration by the Insolvency Act 1986 ("the Act"). It was originally envisaged that a company voluntary arrangement (CVA) could be used in conjunction with administration to allow an insolvent company to renegotiate its debts, with protection from creditor action during negotiations, and continue to trade.³ As Sir Kenneth Cork reflected in his autobiography, many companies in financial difficulty "needed a period when the dogs were called off and they were able to recover a degree of equilibrium."⁴

The administration moratorium has not been embraced in the manner envisaged by the Cork Committee, with very few companies exiting administration via a CVA. In 2013 just 11 of the 554 CVAs commenced did so from administration,⁵ an incredibly low figure when considered against the 2,300-plus administrations commenced in the same year. Despite this, there is evidence to suggest that a moratorium offers real benefits in allowing a financially distressed company the opportunity to review its options and successfully identify the most appropriate outcome. Although use of a moratorium prior to entering into a CVA, either via Administration or the small companies provisions in Sch.A1 to the Act, is low, the outcomes in these cases are generally better. The R3 Report reveals that, whilst only 19 of the 554 CVAs commenced in 2013 were preceded by a formal moratorium, these cases had an implementation rate of over 42% and a termination rate of just 21%. This contrasts significantly to the implementation rate of 18.5% and termination rate of over 65% in the general population.

¹ Available at <https://www.gov.uk/government/consultations/insolvency-and-corporate-governance> Last accessed 28/10/2018

² Available at <https://www.gov.uk/government/consultations/a-review-of-the-corporate-insolvency-framework> Last accessed 28/10/2018

³ *Insolvency Law and Practice: Report of the Review Committee* (HMSO, 1982), Cmnd. 8558, para.423 et seq

⁴ Cork, K. *Cork on Cork* (Macmillan, London, 1988) p.195

⁵ *Company Voluntary Arrangements: Evaluating Success and Failure* (2018) Walton, P, Umfreville, C and Jacobs, L available at

https://www.r3.org.uk/media/documents/policy/policy_papers/corporate_insolvency/R3_ICAEW_CVA_Report_May_2018.pdf ("R3 Report") Last accessed 28/10/2018

A pre-insolvency moratorium is also presently available where a company or its directors intend to appoint an administrator out of court pursuant to para.22 of Sch.B1 to the Act. The giving of notice of this intention to relevant parties triggers a moratorium of up to 10 business days pursuant to para.44. The strategic use of this procedure by a company or its directors to create an extended moratorium, by the filing of successive notices of intention to appoint administrators (NoI), was both acknowledged and prohibited by the Court of Appeal in *JCAM Commercial Real Estate Property XV Ltd v Davis Haulage Ltd* [2017] EWCA Civ 267 (see (2017) 395 Co. L.N. 1 for a discussion of this case and its impact). Whilst there is no available data to assess whether this apparent abuse of the NoI process improved the outcomes of any subsequent process, its sustained use suggests a perceived benefit from the profession at the very least.

The 2016 Consultation Proposals

The Response proposes a new moratorium procedure shaped from the proposals set out in the 2016 Consultation. It is therefore important to revisit these to identify the scope and rationale for the intended reform. The 2016 Consultation recognised the difficulties facing companies seeking to restructure their liabilities in the absence of a viable moratorium when initiating the proposals, whether through consensual agreement, a CVA or a scheme of arrangement. To this end, a pre-insolvency moratorium was proposed to act as a gateway to a variety of restructuring options, both statutory and non-statutory. This was intended to address three issues considered to undermine successful restructuring: the associated cost and risk, the prospect of reaching agreement with creditors, and failure of directors to act early.

A significant motivation behind the 2016 Consultation was the Conservative Party's 2015 manifesto pledge to put the UK in the top five of the World Bank's Doing Business rankings, and be number one in Europe. It is no surprise that the moratorium proposals sought to address the recommendations of the World Bank, in setting out a system of limited but specific duration that strikes a balance between creditor protection and insolvency proceeding objectives.⁶

The moratorium proposed in the 2016 Consultation would be available to all entities with access to administration and CVAs, save for those which have recently been in an insolvency process or are engaged in the finance or insurance sectors. This moratorium would run for up to three months, with the possibility of extension subject to creditor approval. During this period, the directors would retain control, subject to oversight of a supervisor. The moratorium would prevent a range of actions, aligned to those in Sch.A1 to the Act, whilst directors would also be relieved from liability for wrongful trading pursuant to s.214 of the Act for its duration.

Where companies met the eligibility criteria, together with certain qualifying conditions, they would nominate a supervisor with the moratorium commencing extra-judicially by the filing of certain documents with the court and Companies House. To avoid abuse, creditors would have the ability to challenge the moratorium within 28 days of commencement if their interests are unfairly prejudiced or there is a dispute over the qualifying conditions having been met.

To qualify for this moratorium, it was proposed that companies must have sufficient funds to meet their obligations during the moratorium. Additionally, companies would have to demonstrate that

⁶ The World Bank, 'Principles for effective insolvency and creditor/debtor rights systems' (Revised 2015), p.19 Available at [siteresources.worldbank.org/EXTGILD/Resources/5807554-1357753926066/2015_Revised_ICR_Principles\(3\).pdf](https://siteresources.worldbank.org/EXTGILD/Resources/5807554-1357753926066/2015_Revised_ICR_Principles(3).pdf) Last accessed 28/10/2018

there is a reasonable prospect at the outset of agreeing a compromise or arrangement with its creditors. Supervisors would need to be satisfied that these conditions are met at the outset, based on information provided by the directors. Once commenced, the supervisor would be required to ensure ongoing compliance with the qualifying conditions, and bring the moratorium to an end should such compliance cease. Termination would likely lead to a formal insolvency process. Supervisors would obtain this information from directors, who would be obliged to provide it, and by attendance at company meetings.

The role of the supervisor was clearly a key element of the 2016 Consultation moratorium proposals. Despite this, it was not intended that the supervisor be a qualified insolvency practitioner. Instead, the role would also be open to any solicitor or accountant with 'relevant expertise' in restructuring. It was also proposed that supervisors would be prohibited from taking appointment in any formal insolvency process that may follow the moratorium, to ensure independence and avoid conflicts of interest. This was despite the proposal envisaged the moratorium being a potential gateway to administration.

Response to the 2016 Consultation: A revised moratorium to help business rescue

The 2016 Consultation drew significant interest from a broad range of stakeholders. The Government received 71 written responses, in addition to stakeholder meetings and two widely-attended roundtable events during the consultation period. A summary of these responses was published in September 2016, with the Government non-committal about subsequent reform as it was 'continuing to consider the proposals in the light of the responses received.'⁷ Whilst a large majority (67%) of respondents supported the introduction of a pre-insolvency moratorium, a similarly large figure (63%) felt the proposals required more detail. In particular, respondents raised concerns about the proposed length and procedure for extending the moratorium, the efficacy of the creditor safeguards, and the identity and role of the supervisor (see (2016) 388 Co. L.N. 1 for a discussion of the responses).

The Government took some time, and issued a further consultation, *Insolvency and Corporate Governance* in March 2018, before setting out a range of reforms in its Response in late August 2018. Chief amongst these reforms is a new moratorium to help business rescue. Based on the 2016 Consultation framework, with some revisions, this is intended to 'give those financially distressed companies which are ultimately viable, a period of time when creditors (including secured creditors) cannot take action against the company, allowing it to make preparations to restructure or seek new investment.' The revised moratorium proposals address a number of the concerns that were raised following the 2016 Consultation, with some clarification and additional detail in places. There are, though, some elements which continue to raise concerns. Let us then consider the key aspects of the new look moratorium and revisions to that proposed in 2016.

The nature and purpose of the moratorium

The Government intends to introduce a debtor-in-possession pre-insolvency moratorium for virtually all companies. This will be modelled on that currently available in administration. As such, a

⁷ Available at https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/578524/Summary_of_responses_26-10-16_Redacted.pdf Last accessed 28/10/2018

company could not be subjected to the insolvency proceedings or creditor actions in paras.42-43 Sch.B1 of the Act whilst the moratorium is operational, save for with the consent of the company or leave of court. The supervisor would not be able to consent to creditor actions as an administrator can, as management will remain in control of the company. This moratorium will not be available for companies engaged in the finance or insurance sectors (as per the 2016 Consultation) and also those listed in paras.4A-4J Sch.A1 of the Act or within the scope of the Financial Collateral Arrangement Regulations.

Consistent with the 2016 Consultation, the moratorium will act as a gateway to a variety of outcomes. The Government expects typical outcomes to include agreeing an informal restructuring with creditors or entering into a formal insolvency process, which could lead to rescue or liquidation. The Response stresses that the moratorium will not replace existing statutory and non-statutory options, but rather appears intended to facilitate these. The one exception is the Sch.A1 pre-CVA moratorium for small companies, which would be repealed given its impending irrelevance. The scrapping of Sch.A1 of the Act represents a subtle yet significant shift from the 2016 Consultation. Although the original moratorium was purportedly aimed at all companies, the supporting Impact Statement suggested it would be of particular benefit to large companies and used by relatively few companies. This can no longer be the case if the existing moratorium for smaller companies is being removed.

The revised moratorium will operate for 28 days. This is considered a good balance between providing a company time to explore rescue options and the suspension of creditors' enforcement rights. This period can be extended by a further 28 days without creditor or court consent, provided the qualifying conditions (considered below) are still met and creditors are notified. If required, the moratorium could then be extended beyond 56 days if 'there remains a good prospect of achieving a better outcome for creditors than might otherwise be possible.' Such extension will need approval of 50% by value of secured and unsecured creditors. This could be extended by the court if seeking consent from creditors is impracticable, in a similar fashion as for administration in para.76 Sch.B1 of the Act. Additionally, the moratorium will automatically expire if a workout is agreed or insolvency process commenced, and conversely automatically extend where a statutory procedure is proposed to creditors to cover the period for a decision to be reached, whether accepted or rejected.

The reduction in length of the moratorium is a significant shift from the 2016 Consultation proposal for an initial 3 month moratorium extendable only with the consent of secured creditors. This aligns more closely with R3's recommendations for a 21 day pre-insolvency moratorium, published just before the 2016 Consultation.⁸ The Government has also chosen to abandon the questionable proposal that any subsequent administration be reduced by the length of a preceding moratorium. Given the variety of possible outcomes proposed, together with the fact that it is commonplace for administrations to be extended beyond the basic one year period, this is a sensible change.

Accessing the new moratorium

The moratorium will be initiated by the filing of necessary papers at court. This will include the supervisor's consent to act and confirmation that the qualifying conditions and eligibility criteria are satisfied. The supervisor would then need to give notice to all known creditors and Companies House. Creditors would have the option to challenge the moratorium in court should they object. The Response states the commencement process will resemble that for appointing an administrator

⁸ A Moratorium for Businesses: Improving Business & Job Rescue in the UK, R3, April 2016

out of court pursuant to para.22 Sch.B1 of the Act. It remains to be seen whether this will extend to the use of prescribed contents, rather than prescribed forms, as introduced by the Insolvency (England and Wales) Rules 2016. Confusion arising from this approach was evident in the recently reported *Re NJM Clothing Limited (in administration)* [2018] EWHC 2388 (Ch). Given the relatively short period of the moratorium, an approach which leaves the least room for doubt, and therefore challenge, should be adopted.

Eligibility criteria

There has been significant revision of the eligibility criteria for the revised moratorium. The prohibition for companies that have entered into a moratorium, administration or CVA in the previous 12 months remains, however the position with regard to winding up petitions has been refined. A winding-up petition concluded in the previous 12 months without leading to a winding up order will not preclude a company from using the moratorium. Where a winding-up petition is outstanding, the company could now access the moratorium with the court's permission. Here, the moratorium would be initiated via the court, not in the usual manner considered above. The Government is considering whether provision akin to s.127(2) of the Act is required in such circumstances.

The test for entry into the moratorium has also been revised. Gone is the requirement that a company be 'already, or imminently in financial difficulty or insolvent', replaced by the need that a company will 'become insolvent if action is not taken.' This test of prospective insolvency excludes already insolvent companies, to address concerns of the process being abused by directors looking to delay the inevitable, thereby increasing creditor losses. Such companies will still have access to administration, which could of course achieve rescue. This revision makes sense given the additional requirement that the company must have funds sufficient for 'meeting current obligations as and when they fall due as well as any new obligations that are incurred in the moratorium.' Apparently few respondents took issue with this requirement, despite the wide language adopted. These obligations extend beyond trading debts, and could include interest, amortisation, rent, dilapidations and more, which could undermine uptake of the moratorium.

The final limb for eligibility is the prospect of achieving rescue through access to the moratorium. Again, this has been upgraded. The 2016 Consultation required a 'reasonable prospect' of agreeing a compromise or arrangement with creditors. Despite little opposition to this test, the Government has, on reflection and further consultation, raised the bar to 'the balance of probabilities', thus rescue must be more likely than not. Suggestions that access to the moratorium be subject to various creditor notifications or consents has been eschewed, however.

The role of the supervisor

The identity and role of the moratorium supervisor in the 2016 Consultation received significant criticism. The significant responsibilities, combined with broad range of professionals who could fulfil the role, and restrictions on subsequent appointments, raised concerns. These have, to a degree, been addressed in the Response. Failure to do so would have risked the proposed moratorium going the same way as the Sch.A1 Moratorium.

The role has been renamed as a monitor, to avoid confusion between the moratorium and CVAs. Only a qualified insolvency practitioner will be permitted to become a monitor, and will act as an

officer of the court. This is a significant step back from the 2016 Consultation position. Whilst some respondents felt that insolvency practitioners lack the necessary skills to achieve company rescue, they were seen by the majority – particularly creditors – as the only suitable professional for the role. With a view to extending the role in the future, the qualification requirements will be prescribed by regulations, allowing for future revision without recourse to primary legislation.

The role of monitor would be focused on preserving the integrity of the moratorium process and protecting creditor interests. The core functions of assessing and monitoring eligibility at the outset and throughout remain, as does the obligation to immediately terminate the moratorium if the qualifying conditions cease to be met. These decisions will be based on information which directors are obliged to provide. This could prove challenging in a time-pressured debtor-in-possession process. It is not surprising, therefore, that monitors will be given immunity from claims arising from erroneous termination provided they have acted in good faith, to avoid delay in terminations caused by management withholding information. The role has also been expanded, with the monitor required to sanction granting of new security and disposals of assets outside of the company's normal business. This is intended to prevent abuse by rogue directors, though its success will be dependent of the information provided by those directors.

The prohibition in the 2016 Consultation on taking a subsequent appointment in a formal insolvency process to prevent conflicts of interest has been retained for monitors with regard to administration and liquidation. The monitor will now be able to become supervisor of a subsequent CVA. This exclusion is surprising on a number of levels. It is justified on the basis that the moratorium proposals 'are aimed at helping business rescue.' This overlooks the fact that administration is an effective tool for business rescue (and moreover that company rescue is, in statute at least, its primary objective) and that insolvency proceedings, both rescue and terminal, are expected outcomes of the moratorium process. Additionally, the Response makes it clear that there would be no prohibition on monitors providing additional services, such as 'restructuring advice or consultancy services,' to the company using the moratorium. The Insolvency Code of Ethics and existing regulatory regime would apparently protect against conflicts of interest here, but apparently not against conflicts regarding subsequent appointments. Mandating a change of insolvency practitioner when a company exits the moratorium into administration or liquidation will increase the professional costs and potentially cause delays, which will reduce creditor returns. The Government, however, considers this 'a necessary price for creating a positive perception of the new pre-insolvency moratorium.'

Protections and safeguards

The purpose of the moratorium is to encourage corporate rescue, though the need to balance the rights and responsibilities of affected parties is acknowledged. A number of amendments have been made to protect creditors' rights and prevent abuse of the new moratorium process in addition to the various amendments considered above which protect creditors, such as the reduced duration. The proposed suspension of directors' liability for wrongful trading has been abandoned, with the pendulum swinging in the opposite direction through the introduction of sanctions to deter abuse. The scope of these sanctions is to be determined, and could be modelled on those in para.16 Sch.A1 of the Act. Additionally, creditors will be able to challenge a moratorium at any point, not just in the first 28 days as originally proposed. That said, the original proposal to allow creditors to request information at any time during the moratorium appears to have been watered down for fear of the burden on monitors and companies. The Government is looking into a solution for this.

Conclusion

Whereas the late summer bank holiday weekend might usually be considered as a place to bury bad news, the Government's desire to address the deficiencies in the corporate rescue regime and engagement with stakeholder views represent a good news story. The Government has made it clear that it intends to proceed with a new pre-insolvency moratorium. There are still elements that are being finalised, whilst others considered above would benefit from further reflection. Perhaps most importantly, great care is needed to ensure that the negative stigma associated with current insolvency proceedings, acknowledged in the Response, do not undermine the new moratorium and its ability to support rescue, especially given the numerous parallels with administration. Any reform is, however, dependent on the availability of parliamentary time, so perhaps readers should not get too excited just yet.